DEPARTMENT OF STATE REVENUE

Revenue Ruling #2013-04 ST
November 13, 2013

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ISSUE

Sales Tax – Bad Debt Deduction

A company ("Taxpayer") is seeking an opinion as to whether repossessed property used to reduce or offset a federal bad debt deduction should be added back in order to determine the Indiana bad debt deduction for sales tax purposes.

Authority: IC 6-2.5-6-9; Indiana Dep't of Revenue v. 1 Stop Auto Sales, Inc., 810 N.E.2d 686 (Ind. 2004); Wash. Rev. Code Ann. § 82.08.037 (West 2013); Wis. Stat. Ann. § 77.585 (West 2013); Wash. Admin. Code § 458-20-196 (2013); Wis. Admin. Code Tax § 11.30 (2013).

STATEMENT OF FACTS

Taxpayer provides the following facts regarding its request for a revenue ruling. Taxpayer, which is located in Indiana, operates a "buy-here, pay-here" automobile dealership. As part of its operations, Taxpayer finances its customers' automobile purchases and remits the sales tax at the time of the original sale. When one of Taxpayer's customers defaults on its installment contract, Taxpayer determines that a portion of the customer's debt is uncollectible and writes off the bad debt. If the Taxpayer is able to repossess its previously sold vehicle, Taxpayer reduces its bad debt for federal income tax purposes by the value of the recovered property. In particular, Taxpayer further provides an example:

> [Taxpayer] buys car for $5,000 on March 1.
> [Taxpayer] sells car for $10,000 on May 1. There is no trade in in the transaction. Customer is charged $700 in sales tax.
> Customer provides a down payment of $1,000 and signs a contract providing for monthly payments with interest at 14.9% over 48 months.
> Customer makes 2 payments of $269.47, defaults on the contract and [Taxpayer] repossesses the car. The unpaid balance of the contract is $9,400. (Total sales price of $10,700 less $1,000 down, less $300 in principal applied.)
>
> At the time of repossession, [Taxpayer] values the car at $4,400 and return in to inventory for that amount.
>
> For federal income tax purposes, [Taxpayer] claims a bad debt deduction of $5,000. The $5,000 is equal to the unpaid contract balance reduced by the value of the repossessed car.

DISCUSSION

Taxpayer requests that the department rule whether the Indiana bad-debt deduction should be increased to reflect the value of the repossessed vehicle. In other words, should the retail sales tax bad-debt deduction be based on $5,000 (the federal bad debt deduction) or $9,400 (the federal bad-debt deduction plus the value of the repossessed vehicle)?

IC 6-2.5-6-9(d) states in relevant part:

> The following provisions apply to a deduction for a receivable treated as uncollectible debt under subsection (a):
> (1) The deduction does not include interest.
> (2) The amount of the deduction shall be determined in the manner provided by Section 166 of the Internal Revenue Code for bad debts but shall be adjusted to exclude:
> (A) financing charges or interest;

(B) sales or use taxes charged on the purchase price;
(C) uncollectible amounts on property that remain in the possession of the seller until the full purchase price is paid;
(D) expenses incurred in attempting to collect any debt; and
(E) repossessed property.

Taxpayer notes that the Indiana Supreme Court ruled in Indiana Dep't of Revenue v. 1 Stop Auto Sales, Inc., 810 N.E.2d 686 (Ind. 2004) that the term "written off for federal tax purposes" limited the Indiana sales tax bad-debt deduction to the amount written off under I.R.C. Sec. 166 under the pre-2004 version of IC 6-2.5-6-9. Taxpayer also notes IC 6-2.5-6-9 was amended, effective January 1, 2004, and the amended version included the language provided under IC 6-2.5-6-9(d)(2)(E). Thus, Taxpayer asserts, the Indiana bad debt should add back the value of repossessed property.

IC 6-2.5-6-9 was amended in 2003–during the period in which the 1 Stop Auto Sales case was being litigated–not to reflect a clarification or modification of existing Indiana law, but rather as part of Indiana's initial conformity to the Streamlined Sales and Use Tax Agreement (SSUTA), an agreement between 24 states regarding the treatment of sales and use tax transactions. Compare IC 6-2.5-6-9 with SSUTA Sec. 320. Thus, notwithstanding Taxpayer's contention that the General Assembly's 2003 revisions reflected a change to negate 1 Stop Auto Sales with regard to the portion of bad debts attributable to repossessed property, the legislative intent cannot be determined from merely looking at the changes to IC 6-2.5-6-9 in isolation.

While decisions in other jurisdictions and among other states are not dispositive of this issue and are not binding on the department, they do provide persuasive guidance and context for this issue. First, IC 6-2.5-6-9–and SSUTA–reflect the possibility that a federal bad debt deduction could include repossessed property. While no state has issued a reported court decision related to contentions similar to Taxpayer's statutory interpretation, Washington and Wisconsin have enacted statutes similar to IC 6-2.5-6-9. Compare Wash. Rev. Code Ann. § 82.08.037(2) (West 2013) and Wis. Stat. Ann. § 77.585(a) (West 2013). Both Washington and Wisconsin have promulgated regulations and provided examples that reject the position offered by Taxpayer. Wash. Admin. Code § 458-20-196(9)(b)(ii); Wis. Admin. Code Tax § 11.30(2)(f). The department is unaware of any state issuing a ruling or promulgating a regulation consistent with Taxpayer's position. Furthermore, SSUTA–which drafted the provision that was later enacted in Indiana as IC 6-2.5-6-9 –has not issued guidance reflecting agreement to Taxpayer's assertions. Thus, Indiana's interpretation of IC 6-2.5-6-9 is consistent with other states' interpretations of similar statutes and not inconsistent with SSUTA.

The Department's approach also reflects an internal consistency within IC 6-2.5-6-9. For instance, assume that a car is not immediately repossessed, but instead Taxpayer later receives $4,400 in cash--equal to the fair market value of the car. Initially, Taxpayer would have claimed a $9,400 federal bad-debt deduction and received a sales tax refund based on that deduction and any other modifications required by law. When the $4,400 payment is received, IC 6-2.5-6-9(d)(6) requires the proportionate addback to the purchase price and sales tax on the vehicle (in other words, for each $107 received, $100 goes to the purchase price and $7 to sales tax until the taxable price of the vehicle is reached). In the case of default followed by later payment, the bad-debt deduction is generally reduced or recaptured in the amount of the later payment. Taxpayer has not provided a legal or public policy reason that its bad-debt deduction should be different–or, indeed, a greater amount–when the property is immediately repossessed.

Furthermore, if a federal bad-debt deduction included the value of repossessed property, the language of IC 6-2.5-6-9(d)(2)(E) requires a reduction of the bad debt to reflect the fair-market value of the repossessed property. Thus, assuming a $9,400 federal bad-debt deduction in the example provided above, the sales tax bad-debt deduction would be reduced to $5,000 to reflect the repossessed property.

RULING

If a default on a bad debt results in a repossession of property and the federal bad-debt deduction is reduced to reflect the value of the repossessed property, the Indiana sales tax bad-debt deduction is not increased by the value of the repossessed property. If the federal bad-debt deduction includes the value of repossessed property, the sales tax bad debt-deduction is reduced to reflect the value of the repossessed property.

CAVEAT

This ruling is issued to the taxpayer requesting it on the assumption that the taxpayer's facts and circumstances as stated herein are correct. If the facts and circumstances given are not correct, or if they change, then the

taxpayer requesting this ruling may not rely on it. However, other taxpayers with substantially identical factual situations may rely on this ruling for informational purposes in preparing returns and making tax decisions. If a taxpayer relies on this ruling and the department discovers, upon examination, that the fact situation of the taxpayer is different in any material respect from the facts and circumstances given in this ruling, then the ruling will not afford the taxpayer any protection. It should be noted that subsequent to the publication of this ruling a change in statute, regulation, or case law could void the ruling. If this occurs, the ruling will not afford the taxpayer any protection.

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